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SUBJECT: HK OFFICIALS LOOK TO G-20, REGIONAL FINANCIAL
LIBERALIZATION

REF: HONG KONG 421

Classified By: Consul General Joe Donovan, reasons 1.4 b/d

11. (C) Summary: Hong Kong officials will participate in upcoming G-20 meetings as part of the Chinese delegation, focusing on advising senior PRC officials on regulatory and financial sector reforms, U.S. Treasury officials heard during a February 20-24 visit to Hong Kong. Comments by Treasury Secretary Geithner accusing China of manipulating its currency are unlikely to significantly damage his relationship with senior Chinese officials, but former Secretary Paulson's suggestion that Chinese current account imbalances contributed to the U.S. boom and bust have severely damaged his standing in China, Hong Kong contacts told visiting Treasury officials. Chinese financial authorities are worried about the value of their overseas investments, but the economic crisis has spurred additional financial liberalization between Hong Kong and mainland China. In October, officials activated a currency swap to help Hong Kong-based Bank of East Asia secure renminbi financing. End Summary.

12. (SBU) U.S. Treasury Officials from Washington, DC, U.S. Embassy Beijing Finatts, and U.S. Consulate General Hong Kong Economic Unit Chief met with Hong Kong-based analysts, bankers, and Hong Kong financial officials from February 20-24 to discuss Chinese and Hong Kong preparations for upcoming G-20 meetings, U.S-China economic relations, and regional integration, as well as macroeconomic and banking issues (reported septel).

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Hong Kong Officials will Participate in G-20 Meetings

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13. (C) Hong Kong's Undersecretary for Financial Services and the Treasury Bureau (FSTB) Julia Leung and Deputy Chief Executive of the Hong Kong Monetary Authority (HKMA) Peter Pang informed Treasury Deputy Assistant Secretary (DAS) Robert Dohner that the Chinese Central government had invited Hong Kong to join the Chinese delegation at G-20 meetings in London this April. Financial Secretary John Tsang will lead the Hong Kong team, said Leung. HKMA Chief Executive Joseph Yam will also attend. The Chinese Ministry of Foreign Affairs will take charge of the logistics. PRC regulatory bodies, in coordination with Hong Kong bureaus and agencies, are continuing discussions on Chinese positions. Leung noted that Hong Kong authorities highly value their participation in the G-20 meetings, as it allows for additional cooperation on international policy matters through both the HKMA and the FSTB.

14. (C) Hong Kong expects to play an active role in G-20 discussions about international standards and regulatory reform (Working Group One) and financial sector reforms (Working Group Two), but would have less to offer in discussions of IMF and multilateral development bank (MDB) reforms (Working Groups Three and Four), said Leung. Hong Kong's own financial regulatory review, currently underway,

could be a useful reference. HKMA's Pang added that Hong Kong's strong regulatory regime and experience as an international financial center lend it credibility in conversations with Beijing counterparts. Many G-20 members will be lobbying for inclusion in the Financial Stability Forum (FSF - of which Hong Kong is a member), said Pang. He thought it likely that the BRIC countries (Brazil, Russia, India, and China) would be included and added that South Korean officials have been lobbying Hong Kong quite strongly, claiming support from Japan and Singapore. South Korea will chair the G-20 in 2010, which might be reason enough to support their participation in the FSF, he said.

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Protectionist Language Sparks Nervousness
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15. (C) China and Hong Kong officials have been actively discussing the potential for the United States to adopt protectionist policies in response to the economic downturn, said Pang. Comments by U.S. Treasury Secretary Geithner suggesting China was manipulating the value of its currency, combined with well-publicized "Buy America" provisions in the stimulus package originally passed by the U.S. House of Representatives have agitated observers in the region most heavily affected by slowing trade flows. The recent G7 statement was a "good" one, including its references to China's exchange rate regime, said Pang, and settled nerves here. He hoped the G-20 statement would contain similarly strong language opposing protectionist policies, which could "put this issue to bed."

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Naming, Blaming and Shaming Not Helpful
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16. (C) Pang noted Secretary Geithner's comments during his Senate confirmation hearing accusing China of manipulating its currency had ruffled feathers in the region and were not a good start to the relationship. U.S. Embassy Beijing Financial Attach David Loevinger noted to Pang that Secretary Geithner told Chinese Vice Premier Wang that Geithner admired how China had managed the transition of its exchange rate regime. Subsequent conversations with senior Chinese officials have been cordial and have not discussed currency issues.

17. (C) Pang welcomed Secretary Clinton's visit to China and the region, saying that the timing and the message of mutual reliance was "just right." He noted however, that her comment on the U.S. need for China to buy Treasury bonds sent the wrong signal. China's State Administration of Foreign Exchange (SAFE) is concerned about maintaining the value of its U.S. Treasuries and is worried about the potential for additional losses on foreign investments, particularly after Chinese losses on investments in Benelux financial services company Fortis. Chinese leaders believe foreign shareholders' interests were sacrificed to the interests of domestic constituents and will likely be even more cautious in future foreign investments, said Pang.

18. (C) Goldman Sachs Managing Director Fred Hu told DAS Dohner that he believes Secretary Geithner's "manipulation" comment will not hurt his relationship with senior Chinese officials in the long run. Senior leaders understand the U.S. Senate confirmation process, he said, and will give Secretary Geithner the benefit of the doubt for now. Hu added that senior Chinese officials understand the U.S. role in the G-7 and will take the G-7 statement as reflecting the U.S. position. Hu was less optimistic that former Treasury Secretary Paulson's image will quickly recover from his comments, reported in the Financial Times last fall, suggesting Chinese current account imbalances had fueled the U.S. economic boom and bust. Paulson's comments were widely viewed here as trying to shift the blame for the U.S.-created financial crisis to China, Hu said, adding that Paulson's subsequent clarifications have yet to gain much traction in China. It will require much more effort to rehabilitate his

image. In the current economic climate, discussions with the Chinese leadership about imbalances will not be helpful, he offered.

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Crisis an Opportunity for China/HK Financial Liberalization

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¶9. (C) FSTB Undersecretary Leung told Dohner that Hong Kong's government is working hard to position the Special Administrative Region as a renminbi (RMB) financial center and plans to use the recently announced Pearl River Delta development plan to push for greater RMB liberalization. Hong Kong Securities and Futures Commission Deputy Chief Executive Officer Alexa Lam added that large Chinese companies now listed solely on the Hong Kong Stock Exchange (known locally as Red Chips) and other Hong Kong companies could soon pursue A-share or depository receipt listings in mainland China markets. It is a question of timing, rather than policy, she said. This would be another step in integrating the Hong Kong and mainland financial markets.

¶10. (C) HKMA's Pang told DAS Dohner that the recent financial turmoil has provided an opportunity for Hong Kong and Mainland authorities to increase cooperation. In October, when Hong Kong-based Bank of East Asia (BEA) faced RMB shortages in its mainland China operations, HKMA and the People's Bank of China (PBOC) arranged a currency swap to provide BEA with RMB financing. HKMA received RMB in its PBOC account in Beijing, while PBOC was credited with Hong Kong dollars in Hong Kong. HKMA then lent the RMB to BEA for use in China. Although China has negotiated formal swap arrangements with South Korea and Malaysia, only the arrangement with Hong Kong has entered into force and been used, said Pang.

¶11. (SBU) The Treasury delegation has cleared this cable.

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